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Montana Lottery

April 10, 2002

I am pleased to present the Montana Lottery's Fiscal 2001 Annual Report, and "Montana Lottery Snapshot." The Annual Report contains financial information for fiscal years 2001 and 2000, while the "Snapshot" gives a quick reference of the Lottery's fourteen-year history.

In the fourteen years of Lottery operation, it has generated revenue for various State of Montana programs totaling more than $90 million, paid prizes over $190 million, and paid commissions to retailers totaling over $22 million. It is a self-supporting business operation, operating under the guidance of the Lottery Commission.

I believe the enclosed will be informative, and welcome your comments and questions. Please feel free to contact me at 406 444-5825 if I can be of assistance.

Sincerely,

Gerald J. LaChere

Gerald J. LaChere
Director

2525 North Montana Avenue • Helena, MT 59601-0598
Phone 406-444-LUCK (5825) • Fax 406-444-5830

GERALD J. LACHERE
MONTANA LOTTERY DIRECTOR

Director's Message

The Montana Lottery is pleased to present its Fiscal Year 2001 Annual Report. This report contains the Lottery's audited financial statements and information in summary about the Lottery's current products. In addition, this report will look at the directions and plans for Fiscal Year 2002. These directions will lay a foundation for the future of the Lottery.

I am pleased to report the Montana Lottery achieved a slight increase in both overall gross revenue and in transfers to the State of Montana General Fund over fiscal year 2000. Although these increases are not as high as projected, we still managed to increase our ticket sales and, by maintaining our expenditure level, we were able to increase our transfer by nearly $300,000 over fiscal year 2000, transferring 20 percent of our total revenue.

These increases are due in large part to the Lottery staff and their desire to see the Lottery succeed and meet its legislative mandate. Our Lottery Commission has also been instrumental in ensuring our success through their diligence and oversight of our activities and business plans.

Another effort deserving recognition is the support of our retailer network. The 600 retailers across the state continue to provide our products, educate our players, and stand at the front line when we introduce a new game or feature, answering questions of players and non-players, and encouraging participation in the fun offered by the Lottery. They receive little in the way of recognition from the public. The Montana Lottery staff and Commission recognize their contributions.

As we move forward in fiscal year 2002, "change" will continue to be the focus of the Montana Lottery. We will continue to make product and system improvements with the multiple goals of improving customer service for our retailers and players, and maximize revenues for the State of Montana, while at the same time ensuring the security of our products, drawings and computer operations.

Sincerely,

Gerald J. LaChere

Gerald J. LaChere
Director

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ROBERT CRIPPEN, JR.
MONTANA LOTTERY COMMISSION
CHAIR

MONTANA LOTTERY COMMISSIONERS

Bob Crippen, Butte, Chair Cliff Brophy, Columbus Bob Lake, Hamilton
Carol Thomas, Great Falls Tom Keegan, Helena

The Montana Lottery Commission consists of five members appointed by the Governor. By law, one member must be a law enforcement officer, one must be an attorney licensed to practice law in Montana, and one must be a certified public accountant. The Lottery Commission is charged with setting policy for the operation of the Lottery, determining types and forms of lottery games, ensuring the security and integrity of the Lottery, and maximizing revenue paid to the State. The members are appointed to staggered four-year terms. The Commission is required by law to meet at least quarterly to conduct business of the Lottery.

The Montana Lottery is a business that sells tickets for games of chance to the public. In the meantime, the profits benefit the State of Montana. This business is funded by the sales of those products, which pay the costs of running the business, providing personnel, security, administrative, marketing, finance, and information services that are necessary to run the business. The Lottery does not use any funds other than those raised through the sale of Lottery products.

The Montana Lottery celebrated fourteen years of operation in June 2001, ending the year by transferring $6.1 million for the year to the State of Montana General Fund. This makes our total transfer to State programs more than $91million over the past fourteen years. In the meantime, the Lottery has paid over $194 million in prizes to players, and over $22 million to the retailers who sell our products.

The Lottery Commission is pleased to work with the Director and his staff. They continue to search for new ways to operate this multi-million-dollar business, with the twin goals of maximizing revenues for State programs and ensuring the integrity and security of Lottery games.

The Commission appreciates the support of Governor Martz, the network of Lottery retailers, and the citizens of Montana as we continue to do the work we are entrusted with.

LOOKING AHEAD
AT FISCAL YEAR 2002

Fiscal year 2002 will be a year of change for the Montana Lottery. We will build upon our successes of the past years, and, with focused plans allowing enough flexibility to tackle new opportunities as they arise, we will continue to meet our mandate of maximizing revenue for the State of Montana.

The Montana Lottery carefully studies all alternatives before making changes in our products or services. Often, changes are made based on our association with other lotteries through the Multi-State Lottery Association. At other times, we make changes and offer improvements based on the needs or desires of our retailers and players. We often look at changes implemented in other lotteries, evaluate their effects, and make a determination whether or not a similar change would be beneficial for the Montana Lottery and its constituents. All changes are implemented keeping in mind the Lottery's legislative mandate and the sensitivities of the citizens of the state. Following are some opportunities the Montana Lottery sees on the horizon in fiscal year 2002.

Game Enhancements

In the second quartero of fiscal year 2002, the Montana Lottery plans to introduce a Scratch ticket that will sell for $5, offering players more play action on their ticket, and an opportunity to win a larger prize—$50,000. Another planned action is to solidify the $2 ticket in the Montana marketplace. While Bingo and Crossword play styles have been very effective in Montana, other games offered at the $2 price have not been as widely accepted.

Other lotteries have been successful with higher-priced tickets, and we believe that with strategic marketing support, the $2 ticket could be a more profitable product for Montana. The $5 ticket should also offer some players something they desire—a higher top prize—while generating additional revenue for the State of Montana.

Through the Multi-State Lottery Association, ongoing game changes are anticipated in fiscal year 2002. Rolldown, a game offered with nine other states, has not performed as expected, and the game will either be replaced before June 30.

Product Availability Enhancements

The Montana Lottery plans to develop additional full-service retail outlets in the State. After study of our product availability, the Lottery has come to the conclusion that the availability of Lottery products in Montana is more limited than in other lottery states. Our on-line vendor, Scientific Games, has offered a limited number of improved terminals, which will allow the Lottery to strategically increase the number of full-service retailers. There will be more outlets available that offer Lotto games, which should augment the Lottery's sales and transfers to the State of Montana General Fund.

We look forward to Fiscal Year 2002.

SCRATCH

Sold at approximately 600 locations around the State of Montana.
In fiscal year 2001, sales in Scratch tickets totaled $8,950,849.
The Montana Lottery introduced 29 different scratch games in fiscal year 2001.
Prizes paid in fiscal year 2001 totaled $5.8 million.
By law, at least 45 percent of all sales are returned to players as prizes. In fiscal year 2001, the overall percentage was 59%.
Overall odds of winning a prize on Scratch tickets are approximately 1 in four.
Over 180 tickets worth over $250 were paid.
Over 900 tickets worth $100 to $249 were paid.
Over 100,000 tickets worth $10 to $99 were paid.
Over 1.4 million tickets worth $1 to $9 were paid.
Total number of winners in fiscal year 2001 was approximately 1.5 million.
Each Lottery retailer receives a 5% commission on the gross sales, with the potential for earning additional commissions on sales over base. Retailer commissions in fiscal year 2001 totaled over $660,000.

MONTANA CA$H

Sold at approximately 400 locations around the State of Montana.
In fiscal year 2001, Montana Cash sales totaled $3,809,913.
Montana Cash prizes paid in fiscal year 2001 totaled over $2.1 million.
By law, at least 45 percent of all sales are returned to players as prizes. In fiscal year 2001, the overall percentage was slightly over 56%.
Overall odds of winning a prize in Montana Cash are 1 in 43.
Seventeen jackpot tickets worth from $20,000 to $150,000 were sold.
Over 2,700 tickets worth $200 were sold.
Over 86,000 tickets worth $5 were sold.
Total number of winners in fiscal year 2001 was over 88,000.
Each Lottery retailer receives a 5% commission on the gross sales. Retailer commissions in fiscal year 2001 totaled over $190,000.

WILD CARD 2

Sold in Montana, Idaho and South Dakota.
Sold at approximately 400 locations around the State of Montana.
In fiscal year 2001, Wild Card sales in Montana totaled $2,860,879.
Wild Card prizes paid in fiscal year 2001 totaled nearly $1.5 million.
By law, at least 45 percent of all sales are returned to players as prizes. In fiscal year 2001, the overall percentage was slightly over 52%.
Overall odds of winning a prize in Wild Card are 1 in 6.
One jackpot ticket, worth $145,000, was sold in Montana in fiscal year 2001.
Over 300 tickets worth over $250 were sold.
Over 4,000 tickets worth $10 to $99 were sold.
Over 459,000 tickets worth $1 to $9 were sold.
Total number of winners in fiscal year 2001 was approximately 463,000.
Each Lottery retailer receives a 5% commission on the gross sales. Retailer commissions in fiscal year 2001 totaled over $140,000.

POWERBALL

MONTANA POWER Power Play

Sold in 20 other states and the District of Columbia
Sold at approximately 400 locations around the State of Montana.
In March 2001, the Powerball game introduced a feature called Power Play, in which customers have a chance to multiply their prizes up to five times.
In fiscal year 2001, Powerball sales in Montana totaled $13,812,903.
Powerball prizes paid in fiscal year 2001 totaled nearly $6.6 million.
By law, at least 45 percent of all sales are returned to players as prizes. In fiscal year 2001, the overall percentage was slightly over 47%.
Overall odds of winning a prize in Powerball are 1 in 35.
Over 180 tickets worth over $250 were sold.
Over 900 tickets worth $100 to $249 were sold.
Over 100,000 tickets worth $10 to $99 were sold.
Over 1.4 million tickets worth $1 to $9 were sold.
Total number of winners in fiscal year 2001 was approximately 1.5 million.
Each Lottery retailer receives a 5% commission on the gross sales. Retailer commissions in fiscal year 2001 totaled over $691,000.

Cash 4 Life MONTANA

The game ended September 7, 2000, with the introduction of Rolldown.
In fiscal year 2001, Cash 4 Life sales in Montana totaled $129,900 (July 1 – September 7, 2000).
One ticket worth $25,000 was sold in July 2000.
Cash 4 Life prizes paid in fiscal year 2001 totaled $42,600.
Retailer commissions were approximately $6,500.

Rolldown MONTANA

Introduced in Montana and nine other states on September 8, 2000.
Sold at approximately 400 locations around the State of Montana.
In fiscal year 2001, Rolldown sales in Montana totaled $802,081.
Rolldown prizes paid in fiscal year 2001 totaled over $369,000.
By law, at least 45 percent of all sales are returned to players as prizes. In fiscal year 2001, the overall percentage was slightly over 46%.
Overall odds of winning a prize in Rolldown are 1 in 17.
Over 50 tickets worth over $250 were sold.
Over 2,800 tickets worth $10 to $99 were sold.
Over 45,000 tickets worth $1 to $9 were sold.
Total numbers of winners in fiscal year 2001 were approximately 48,000.
Each Lottery retailer receives a 5% commission on the gross sales. Retailer commissions in fiscal year 2001 totaled over $40,000.

INDEPENDENT AUDITORS' REPORT

Independent Auditor's Report

To: The Commissioners

Montana State Lottery
Helena, Montana

We have audited the accompanying financial statements of Montana State Lottery (Lottery), an enterprise fund of the State of Montana, as of and for the years ended June 30, 2001 and 2000. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note A, the financial statements present only the Montana State Lottery and are not intended to present the financial position of the State of Montana and the results of its operations and cash flows of its proprietary fund types and non-expendable trust funds in conformity with generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Montana State Lottery, an enterprise fund of the State of Montana, as of June 30, 2001 and 2000, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated October 5, 2001 on our consideration of the Montana State Lottery's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Galusha, Higgins & Galusha, PC

GALUSHA, HIGGINS AND GALUSHA, PC
Certified Public Accountants and Advisors
Helena, Montana
October 5, 2001

MONTANA STATE LOTTERY
BALANCE SHEETS

Financial Statements

JUNE 30,	2001	2000
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$1,216,236	$1,748,886
Accounts receivable, net of allowance	898,301	682,506
Due from other funds	1,955	2,236
Inventory	1,151,747	1,121,826
Cash collateral - security lending transactions	0	79
Other current assets	11,609	26,084
Total current assets	*3,279,848*	*3,581,617*
FURNITURE AND EQUIPMENT		
Furniture, fixtures and equipment	4,769,593	4,248,387
Accumulated depreciation	(1,514,826)	(997,780)
	3,254,767	*3,250,607*
INTANGIBLE ASSETS		
Software, net of accumulated amortization	780,357	944,643
Other intangibles	4,940	12,219
	785,297	*956,862*
OTHER ASSETS		
MUSL prize reserve receivable	2,265,496	2,102,186
	$9,585,408	*$9,891,272*
LIABILITIES AND FUND EQUITY		
CURRENT LIABILITIES		
Accounts payable	$496,198	$624,438
Accrued interest payable	29,278	38,085
Estimated prize liability	1,534,740	1,090,010
Transfer obligations to General Fund	1,901,484	1,505,918
Liability under security lending transactions	0	79
Due to other state agencies	88,485	81,187
Other current liabilities	59,164	147,840
Current portion of long-term debt	1,002,466	952,741
Total current liabilities	*5,111,815*	*4,440,298*
LONG-TERM LIABILITIES		
MUSL prize reserve liability fund	1,898,011	1,873,671
Note payable	2,164,622	3,167,088
Accrued compensated absences	173,277	172,532
	4,235,910	*5,213,291*
	9,347,725	*9,653,589*
FUND EQUITY		
Retained earnings	0	0
Contributed capital	237,683	237,683
	$9,585,408	*$9,891,272*

The accompanying notes are an integral part of these financial statements.

MONTANA STATE LOTTERY
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN RETAINED EARNINGS

Financial Statements

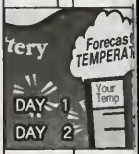
FOR THE YEARS ENDED JUNE 30,	2001	2000
OPERATING REVENUES		
Instant ticket games	$8,950,849	$9,060,981
On-line games	21,415,677	20,838,828
Miscellaneous	56,600	76,863
Total operating revenues	*30,423,126*	*29,976,672*
COST OF TICKET REVENUES		
Instant ticket prize expense	5,295,632	5,266,102
On-line ticket prize expense	10,433,842	10,309,291
Retailer commission	1,732,572	1,745,566
On-line vendor fees	2,535,067	2,496,870
Cost of tickets sold	640,823	625,654
Total cost of ticket revenues	*20,637,936*	*20,443,483*
Net operating revenues	*9,785,190*	*9,533,189*
OPERATING EXPENSES		
Advertising	566,195	603,239
Other communications	118,716	124,705
Advertising production	128,764	132,005
Audit fees	44,207	41,307
Other contractual services	217,919	142,545
Depreciation and amortization	784,320	758,527
Management fees	123,926	122,851
Multi-state operating fees	49,614	109,746
Other	95,857	75,402
Personal services	1,260,377	1,258,234
Repairs and maintenance	35,918	47,526
Supplies and materials	179,462	166,931
Utilities and rent	98,494	100,013
Travel	24,923	27,089
Total operating expenses	*3,728,692*	*3,710,120*
OPERATING NET INCOME	*6,056,498*	*5,823,069*
NON-OPERATING REVENUES (EXPENSES)		
Interest income	275,304	278,386
Interest expense	(184,029)	(231,724)
Security lending income	616	5,921
Security lending costs	(599)	(5,687)
Loss on disposal of furniture and equipment	(3,114)	(28,980)
Total non-operating net income	*88,178*	*17,916*
INCOME BEFORE OPERATING TRANSFERS	*6,144,676*	*5,840,985*
OPERATING TRANSFERS OUT		
General Fund	6,144,676	5,840,985
Total operating transfers out	*6,144,676*	*5,840,985*
Retained earnings, beginning of year	*0*	*0*
Retained earnings, end of year	*$0*	*$0*

The accompanying notes are an integral part of these financial statements.

MONTANA STATE LOTTERY
STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED JUNE 30,	2001	2000
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from sales	$30,109,214	$31,119,016
Cash paid to suppliers for goods and services	(6,625,036)	(6,976,426)
Cash paid to employees	(1,276,115)	(1,263,022)
Cash paid for prizes	(15,305,456)	(15,969,035)
Net cash provided by operating activities	*6,902,607*	*6,910,533*
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES		
Operating transfers out:		
General fund	(5,749,110)	(7,177,785)
Net cash used by non-capital financing activities	*(5,749,110)*	*(7,177,785)*
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Purchase of fixed assets	(629,632)	(23,338)
Interest paid	(192,836)	(240,095)
Payments on long-term borrowing	(952,741)	(905,482)
Proceeds from sale of fixed assets	2,325	3,995
Net cash used by capital and related financing activities	*(1,772,884)*	*(1,164,920)*
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest income	86,720	124,405
Security lending income	616	5,921
Security lending costs	(599)	(5,687)
Net cash provided by investing activities	86,737	124,639
NET DECREASE IN CASH AND CASH EQUIVALENTS	*(532,650)*	*(1,307,533)*
Cash and cash equivalents, beginning of year	1,748,886	3,056,419
Cash and cash equivalents, end of year	*$1,216,236*	*$1,748,886*
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating income	$6,056,498	$5,823,069
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	784,320	758,527
Changes in net assets and liabilities:		
(Increase) decrease in accounts receivable	(215,796)	1,069,175
Decrease in due from other state agencies	281	2,090
Increase in inventory	(29,921)	(377,560)
Decrease in other current assets	14,475	7,585
Increase in long-term receivable	(163,310)	(87,767)
Interest receivable included in long-term receivable	188,583	153,982
Decrease (increase) in other intangible assets	7,279	(6,234)
Decrease in accounts payable	(128,240)	(107,506)
Increase (decrease) in lottery prizes payable	469,070	(393,642)
(Decrease) increase in other current liabilities	(88,676)	73,169
Increase in due to other state agencies	7,299	433
Increase (decrease) in compensated absences payable	745	(4,788)
Net cash provided by operating activities	*$6,902,607*	*$6,910,533*

The accompanying notes are an integral part of these financial statements.



JUNE 30, 2001 and 2000

NOTE A–SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization - The Montana State Lottery (hereafter referred to as the Lottery) was created in November 1986 by a referendum vote of the people of Montana.

Section 23-7-101, Montana Code Annotated (MCA) establishes the provision of the code under which the Lottery operates. The Lottery is operated by a five-member commission consisting of Montana residents appointed by the Governor. The Commission, by law, has the power to operate a state lottery, determine the type and forms of lottery games, set ticket prices, determine the number and size of prizes, conduct lottery drawings, enter into agreements to offer lottery games with other states, and prepare financial reports. The Lottery is attached to the Montana Department of Commerce for administrative purposes. An organizational change effective July 1, 2001 transferred the Lottery to the Department of Administration.

Disposition of revenue is a minimum of 45 percent for prizes and a maximum of 10 percent for commission to sales agents. The remaining revenue, less operating expenses, is transferred to the Montana State General Fund.

Reporting Entity - The Lottery is included in the State of Montana's financial statements as an enterprise fund. In accordance with governmental accounting and financial reporting standards, there are no component units to be included within the Lottery's financial statements as a reporting agency.

Basis of Accounting - The Lottery utilizes the accrual basis of accounting and is classified as an enterprise fund of the governmental proprietary fund type. Enterprise funds account for operations similar to private business enterprises where the intent of the Legislature is that costs are to be financed or recovered primarily through user charges, or where the Legislature has decided that periodic determination of revenue earned, expenses incurred or net income is appropriate.

Revenue Recognition - Sales of instant lottery tickets are made to licensed retailers who market the tickets to the public on a commission basis. Revenue is recognized when tickets are activated by retailers. Tickets activated, but not sold by retailers, may be returned for credit. Sales are reduced for estimated ticket returns.

Sales of on-line lottery tickets are made to licensed retailers who market the tickets through the use of computerized terminals on a commission basis. Revenue is recognized on drawing dates. Tickets sold in advance of future drawing dates are recorded as deferred revenue until the ticket becomes valid for a drawing.

Cash and Cash Equivalents - Cash and cash equivalents consist of interest-bearing deposits with the Montana Board of Investments Short-Term Investments Pool, cash deposited with banks and cash on deposit with the Montana State Treasurer that is part of the State's pooled cash and is not separately identifiable as to specific types of securities. These funds are highly liquid and may be drawn on daily.

Allowance for Uncollectible Accounts - The Lottery uses the allowance method to account for uncollectible receivables. The allowance is based on management's estimate of possible bad debts.

Advertising Costs - Advertising costs are expensed as incurred.

Allowance for Returned Tickets - The Lottery's policy is to accept any unscratched instant ticket from a retailer for credit without regard to when the ticket or pack of tickets was activated. Therefore, an allowance to recognize the possibility of returns is calculated at the end of each fiscal year.

Inventory - Inventory consists of tickets and supplies. Ticket inventory includes instant lottery tickets that are carried at cost using the specific identification method. Tickets are charged to cost of sales when activated.

Unsold tickets are charged to cost of sales upon the end or cancellation of the related game. Supply inventory is carried at cost and expensed as used.

Prizes - Prize expense is recognized based on a predetermined prize structure for each instant ticket and on-line game. Free tickets are recorded as a reduction in revenue and not as prize expense.

Unclaimed Prizes - Prizes for the online games, Powerball, Wild Card, Cash 4 Life (discontinued in September, 2000), Rolldown, and Montana Cash, must be claimed within six months after the appropriate draw date. Prizes for instant games must be claimed within six months of the announced end of each game. The unclaimed prize amounts are taken as a reduction in the Lottery Prizes Payable liability and the Prize Expense and are transferred to the State of Montana General Fund as a portion of the quarterly transfer. The combined amounts of unclaimed prizes for online games were $731,241 and $490,243 and for the instant games were $186,648 and $316,667 for the fiscal years ended June 30, 2001 and 2000, respectively.

Intangible Assets - Intangible assets consists of the following:

Software represents the unamortized cost of software purchased in 1999. This software had an original cost of $1,150,000 and is being amortized over seven years.

Other intangibles represents the per ticket cost paid to Autotote Lottery Corporation for advance on-line ticket sales. These ticket sales, recorded as deferred revenue, represent tickets sold prior to June 30, 2001 and 2000 for drawings held subsequent to fiscal year-end.

Furniture and equipment - Furniture and equipment are recorded at cost. Donated furniture and equipment are recorded at their estimated fair market value at the date of donation. Ordinary maintenance and repairs are charged to operations as incurred; major renewals and betterments are capitalized. Upon disposition or retirement of furniture and equipment, the cost and related accumulated depreciation or amortization is removed from the accounts. Gain or loss on disposal is reflected in nonoperating revenues and expenses. Depreciation and amortization are calculated on a straight-line basis over estimated useful lives of two to ten years. The Lottery conforms to the State of Montana capitalization threshold for recording furniture and equipment. This threshold is $5,000.

Contributed Capital - Contributed capital represents equity acquired through contributions from vendors and the State of Montana.

Compensated Absences - State employees earn vacation leave ranging from fifteen to twenty-four days per year based on years of service. Vacation leave may be accumulated to a total not to exceed twice the maximum number of days earned annually. Sick leave accumulates at a rate of twelve days per year with no maximum accumulation. Upon retirement or termination, an employee is paid for 100 percent of unused vacation leave and 25 percent of unused sick leave.

Use of Estimates - The preparation of financial statements in conformity with Generally Accepted Accounting Principles (GAAP) requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

NOTE B–CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of the following:

June 30,	2001	2000
Short-term investment pool	$1,069,565	$1,022,827
Cash on deposit with State Treasurer	136,521	715,909
Cash in revolving deposit account	10,000	10,000
Petty cash	150	150
	$1,216,236	$1,748,886

The Lottery participates in the Montana Board of Investments Short Term Investment Pool (STIP). STIP balances are highly liquid investments with maturities of 397 days or less. There are no legal risks that the Board of Investments is aware of regarding any STIP investments. The bank balance of the revolving deposit account was $25,897 and $16,848 at June 30, 2001 and 2000, respectively, and was covered by federal depository insurance. The carrying amount reported in the balance sheet for cash and cash equivalents approximates the fair market value.

NOTE C–ACCOUNTS RECEIVABLE

Accounts receivable consists of the following:

June 30,	2001	2000
Accounts receivable	$1,072,505	$911,947
Allowance for uncollectible accounts	(5,900)	(668)
Allowance for returned tickets	(168,304)	(228,773)
	$898,301	**$682,506**

NOTE D–INVENTORY

Inventory consists of the following:

June 30,	2001	2000
Instant scratch tickets	$947,277	$973,829
Supplies	204,470	147,997
	$1,151,747	**$1,121,826**

NOTE E–OTHER CURRENT ASSETS

Other current assets consist of the following:

June 30,	2001	2000
Prepaid expenses	$6,809	$21,784
Employee travel advances	4,800	4,300
	$11,609	**$26,084**

NOTE F–FURNITURE AND EQUIPMENT

A summary of furniture and equipment for the Montana Lottery is as follows:

June 30,	2001	2000
Furniture, fixtures and equipment	$4,769,593	$4,248,387
Accumulated depreciation	(1,514,826)	(997,780)
Total	**$3,254,767**	**$3,250,607**

NOTE G–MULTI-STATE LOTTERY ASSOCIATION (MUSL)

Joint Venture Association - In November 1989, the Lottery joined the Multi-State Lottery Association (MUSL). MUSL was created in September 1987 to operate a multi-state lottery game for the benefit of party lotteries. The Powerball game, Wild Card game and Rolldown game are presently the only games operated jointly by the members. The Cash 4 Life game was discontinued in September, 2000. Each lottery participating in MUSL is represented on the Board of Directors.

Prize Reserve Fund Receivable/Liability - As a member of the MUSL, the Lottery is required to contribute to various prize reserve funds maintained by MUSL. The contributions are to be used to fund unanticipated prize claims. All funds remitted and the related interest earnings will be returned to the Lottery upon leaving the association, less any portion of unanticipated prize claims, which may have been paid from the fund.

The Lottery contributes to the reserve fund through the set-aside for prizes. Payments made to the reserve fund are considered a portion of the prize expense associated with the on-line game.

During 1990, the MUSL Board created the unreserved accounts to record interest earned on the various prize reserve funds when the prize reserve fund balance is not below the predetermined ceiling amount. The amounts in the unreserved accounts may be used at the Board's discretion.

The long-term receivable balance of $2,265,496 and $2,102,186 at June 30, 2001 and 2000, respectively, represents the Lottery's share of the MUSL prize reserve fund that had a balance of $97,667,729 and $102,899,124 for 2001 and 2000, respectively. The long-term liability balance of $1,898,011 and $1,873,671 at June 30, 2001 and 2000, respectively, represents the Lottery's share of the total estimated prize liability.

Lotto*America Prizes and Investments - Prizes awarded to Lotto*America grand prize winners are paid in twenty annual installments funded by investments in United States Treasury zero coupon bonds. Bonds purchased on behalf of Montana source winners are held in trust by MUSL with the Lottery as beneficiary. As the bonds mature, the proceeds are forwarded to the Lottery and distributed to the grand prize winners on the anniversary date of each win.

At June 30, 2001 and 2000, MUSL held United States Government zero coupon bonds in trust for the Lottery winners with respective par values of $60,373,949 and $65,581,948 and respective market values of $44,348,279 and $44,379,780.

The Lottery has eight Lotto*America/Powerball/Tri-West winners. The combined total future prize payments owed is $60,373,000 and $65,581,000, at June 30, 2001 and 2000, respectively. Total annual payments due over each of the next five years is $5,208,000 annually and $34,333,000 thereafter. The present value of future prize payments approximates the current market value of the bonds held in trust for the Lottery winners.

Multi-State Lottery Association Financial Position - Information related to the Multi-State Lottery Association's audited financial statements is as follows:

June 30,	2001	2000
Total assets	$1,315,863,534	$1,433,307,032
Total liabilities	1,315,536,546	1,433,128,671
Total net assets	326,988	178,361
Total liabilities and net assets, unrestricted	$1,315,863,534	$1,433,307,032
Total revenues	$5,192,361	$2,865,781
Total expenses	5,043,734	2,916,171
Increase (decrease) in unrestricted net assets	$148,627	($50,390)

NOTE H–ESTIMATED PRIZE LIABILITY

The estimated prize liability represents the Lottery's estimate of prizes payable related to games in process at year-end based on the predetermined prize structure of each outstanding game.

NOTE I–OBLIGATION TO TRANSFER FUNDS

The Lottery is required to transfer its net revenue to the Montana State General Fund. This change was enacted through the passage of SB 83 by the 1995 Legislature and signed into law by Governor Racicot in April 1995. Transfer obligations outstanding at June 30, 2001 and 2000 were $1,901,484 and $1,505,918, respectively.

NOTE J–OTHER CURRENT LIABILITIES

Other current liabilities consist of the following:

June 30,	2001	2000
Property held in trust	$-0-	$1,500
Deferred on-line revenue	59,164	146,340
	$59,164	$147,840

NOTE K–LONG-TERM LIABILITIES

Long-term liabilities consist of the following:

June 30	Current	Long-Term	2001 Total	2000 Total
Prize liability				
Multi-State Lottery Association		$1,898,011	$1,898,011	$1,873,671
Accrued compensated absences		173,277	173,277	172,532
Note payable -				
Norwest Investment,				
interest rate 5.12% for 5 years requiring				
quarterly payments of $286,394.30.	$ 1,002,466	2,164,622	3,167,088	4,119,829
	$ 1,002,466	$4,235,910	$5,238,376	$6,166,032

Future scheduled principal maturities of the long-term note payable are as follows:

2002	$1,002,466
2003	$1,054,786
2004	$1,109,836
2005 and beyond	$0
Total	$3,167,088

NOTE L–LEASES

The Lottery leases its office, administrative and warehouse facilities under a lease agreement expiring February 2002. Rent expense under operating leases charged to operations was $78,000 for the years ended June 30, 2001 and 2000.

The Lottery also has an operating lease for office equipment, primarily the photocopier, with monthly payments of $456, which expires August 2002. A separate maintenance agreement exists which follows the terms of the original lease. This agreement requires minimum payments of $95 per month or actual usage costs whichever is larger. Rental expenses for these leases consisted of $6,612 for the year ended June 30, 2001.

Future minimum lease payments under operating leases that have remaining terms in excess of one year as of June 30, 2001 are:

2002	$54,612
2003	$1,102
Total	$55,712

NOTE M–EMPLOYEE BENEFIT PLANS

Pension Plan - The Lottery participates in the Public Employees Retirement System (PERS). PERS is a statewide mandatory cost-sharing multiple employer defined benefit retirement plan which covers all employees. The plan is established under State law and is administered by the State of Montana. The plan provides retirement, disability, and death benefits to plan members and beneficiaries.

The plan issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained from the following address: Public Employees Retirement System, Montana Public Employees Retirement Administration, P.O. Box 200131, 100 N. Park, Suite 220, Helena, MT 59620-0131, (406) 444-3154.

The contribution rate for the plan is required and determined by State law. The contribution rate for fiscal years 2001 and 2000, expressed as a percentage of covered payroll, was 6.9% for both years, for both the employer and the employees.

The amounts contributed to the plan during the years ended June 30, 2001 and 2000, were $134,636 and $128,372, respectively, and were equal to the required contributions for each year.

Deferred Compensation Plan - The Lottery's full-time regular employees are eligible to participate in the State of Montana's deferred compensation plan. The plan is administered by Benefits Corporation on behalf of Great West Life Insurance Company through a contract with the State of Montana. The

amount of compensation deferred is not available to employees until termination, retirement, death, or unforeseen emergency. All amounts are deferred under the plan created under Internal Revenue Code Section 457 and Title 19, chapter 50, Montana Code Annotated (MCA). Assets of the deferred compensation plan are required to be held in trusts, custodial accounts or insurance company contracts for the exclusive benefit of participants and their beneficiaries.

NOTE N–RELATED PARTY TRANSACTIONS

During the ordinary course of business, other State agencies provide certain services and supplies to the Lottery. During 2001 and 2000, total payments to other State agencies were approximately $327,070 and $317,000, respectively.

NOTE O–COMMITMENTS AND CONTINGENCIES

Instant Tickets - The Lottery has an agreement with Oberthur Gaming Technologies Corp. to print instant game tickets. The original agreement expired June 30, 2001. The Lottery obtained proposals from March 2001 through June 2001, when they awarded the contract to Oberthur. The new contract expires June 30, 2002 but has the option for six one-year renewals.

Maintenance Contract - The Lottery had an agreement with Stratus Computer, Inc. to provide for computer hardware and software maintenance. The agreement provided for quarterly payments of $9,587. The Lottery exercised its option to terminate the agreement effective March 1, 2000.

On-line Vendor - The Lottery is contracted with Autotote Lottery Corporation to provide for the operation of an on-line gaming system through March 30, 2006. The estimated total contract price is approximately $24 million over the seven-year contract.

Advertising - The Lottery signed a contract with Banik & Associates to provide advertising services for $8,400 per month through December 2001.

Independent Observation of Drawings - The Lottery is committed to Henry Fenton, CPA, to observe Montana Cash and other special drawings. The term of the contract is for one year ending June 30, 2001. This contract was renewed for one year. Compensation will not exceed $8,000.

Audit of Financial Statements - The Lottery is party to a contract with Galusha, Higgins and Galusha, PC, an independent accounting firm, to audit the Lottery's annual financial statements. The yearly contract was finalized on June 7, 1999, and is renewable annually for six years with the consent of all parties. Compensation for the years ended June 30, 2001 and 2000, will not exceed $11,500 and $10,500, respectively.

Prize Contingencies - Certain Big Spin prizes awarded are payable to the winners in annual installments spanning seventeen to twenty years with the first payment being made by the Lottery. The Lottery has entered into agreements with an insurance carrier under which purchased annuities will provide the required level of payments corresponding to the Lottery's obligation to these prize winners. Because it is the intent of the Lottery that the insurance carrier will make future installment payments directly to each prize winner, neither the present value of the annuities nor the present value of the future payments are reflected in the accompanying financial statements. The Lottery would be liable for such future payments in the gross amount of $1,456,765 and $1,734,559 at June 30, 2001 and 2000, respectively, if the insurance carrier defaulted on their payments.

NOTE P–RISK MANAGEMENT/PUBLIC ENTITY RISK POOL

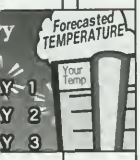
The Lottery contributes to the Group Employee Comprehensive Medical and Dental Plan and the Property and Casualty Insurance plans of the State of Montana. Details of these plans can be found in the State of Montana Comprehensive Annual Financial Report.

NOTE Q–RECLASSIFICATIONS

Certain accounts in the prior-year financial statements have been reclassified for comparative purposes to conform with the presentation in the current-year financial statements.

INDEPENDENT AUDITORS' REPORT

ON COMPLIANCE AND ON INTERNAL CONTROL
OVER FINANCIAL REPORTING BASED ON
AN AUDIT OF FINANCIAL STATEMENT PERFORMED
IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*



Independent Auditor's Report

October 5, 2001

To the Commissioners
Montana State Lottery
Helena, Montana

We have audited the financial statements of Montana State Lottery (Lottery), an enterprise fund of the State of Montana, as of and for the year ended June 30, 2001, and have issued our report thereon dated October 5, 2001. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Lottery's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Lottery's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended for the information of the Lottery's Commissioners, management and the Legislative Audit Committee and is not intended to be and should not be used by anyone other than those specified parties.

Galusha, Higgins & Galusha, PC

GALUSHA, HIGGINS AND GALUSHA, PC
Certified Public Accountants and Advisors

win at your own game

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